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TAGS: ETRD ECON EINV PK
SUBJECT: PAKISTAN'S TEXTILE EXPORTS DROP; COMPETITIVENESS AN ISSUE

REF: STATE 114799

Summary
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¶1. (SBU) Textiles and apparel account for 38 percent of Pakistan's total industrial production but almost 2/3 of exports. Despite $6 billion in investment in the textile sector in the last six years, textile exports growth slowed down in FY07 to just 5.2 percent versus last year's 16.8 percent. Textile exporters attribute the slowdown to high utility charges, low labor productivity, competition from India, China, Bangladesh and Sri Lanka and high cotton prices. While Pakistan provides various tax breaks and duty concessions to the textile industry, GOP officials maintain that it is unable to remain competitive in the world market due to inability to match textile sector subsidies by the governments of India, Bangladesh and China.

¶2. (SBU) Pakistan is a beneficiary of various preference programs including a FTA with China that extends duty free access to most textiles and apparel, the South Asian Free Trade Area and EU GSP program. However, high production costs and a focus on low value products mean that Pakistan is unable to take full advantage of the current preference programs. GOP officials allege that its exclusion from the EU's GSP-Plus program favors Bangladesh and Sri Lanka over Pakistan. Pakistan exports mostly raw material and yarn to China rather than manufactured products. However, U.S and EU safeguards on Chinese textiles have helped Pakistani exports, but their expiration in 2008 may further hit market share and stunt potential growth.

Textile and Apparel Production
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¶3. (U) Pakistan's textile and apparel production was $12.04 billion, or 38 percent of total industrial production of $26.18 billion, for the Pakistani fiscal year 2006-2007 which ended June
¶30. This represents a 2.1 percent decrease over the previous fiscal year. The industrial sector employed approximately 6.9 million

workers; the textile industry's share of industrial employment was estimated at 38 percent, or 2.6 million. The GOP estimated total textile sector employment at 16 million, which includes cotton farmers and ginners. In FY07, textiles' share of total exports was 63.2 percent.

Mixed Price Trends

¶4. (U) Textile price trends were mixed, with the value of some export categories rising while others declined. From FY06 to FY07, the price of cotton yarn increased by 2.9 percent, while knitwear .prices increased by 1.79 percent. During the same period, prices for Pakistani bed linens dropped by 1.28 percent, while readymade garment prices fell by 3.92 percent. The price of cotton cloth, however, increased by 15.1 percent. The GOP calculated that unit price drops in major textile exports from July 2006 to April 2007, compared to a year earlier, translated into a loss of $484 million in export revenue.

¶5. (SBU) GOP interlocutors attributed the price decline to competition from low-priced Chinese, Indian and Bangladeshi textiles, increases in prima cotton prices used in the production of bed wear and garments and use of contaminated domestic cotton. (Comment: In some cases, cotton producers do not remove foreign materials during the cotton and seed separation process. These materials (e.g. hair, dust, pieces of cloth) are then incorporated into the thread and cloth. No data is available regarding the magnitude of this problem or export revenue foregone because of low-priced contaminated cotton. End comment.) The GOP has begun a small-scale program to encourage farmers to clean cotton properly. Pakistan receives very little foreign direct investment in the

textile and apparel sector - less than $50 million, or 1.2 percent of total FDI between July 2006 and April 2007.

Textile Export Performance Falters
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¶6. (SBU) More than 24 months after the end of the Multi Fiber agreement, Pakistan's exports decreased in FY2006-07. After 16.8 percent YoY growth in FY06, textile exports increased only by 5.2 percent to $10.75 billion in FY07. Even star categories like cotton cloth exports (11.8 percent of total exports) dropped by 4.3 percent and bed linens exports (11.5 percent of total exports) slumped by 3.9 percent. However, finished garment exports increased by 5.3 percent and knitwear exports increased by 12.1 percent. Yarn exports, principally to China, Bangladesh and Sri Lanka, were up by 3.1 percent. Increased competition principally from China, India, Bangladesh and Turkey, combined with Pakistan's focus on lower value added products are reasons for this mixed picture.

¶7. (SBU) Pakistan only had limited success in diversifying its exports beyond the textile sector. Textiles increased as a share of total exports from 62.1 in FY06 to 63.2 percent in FY07. Pakistani textile exports to the U.S. dropped by 4.5 percent, compared to China (up 27.3%) and India (down 0.6 %) during January-July 2007. The removal of safeguard measures by the U.S. and EU on textile exports from China in 2008 will further hit Pakistan's textile exports. (Comment: In our conversation with GOP trade and finance officials, we've noted a lack of planning for what will happen once the China safeguards expire in 2008. End comment.)

¶8. (SBU) Pakistan's private sector has invested $6 billion in the textile industry over the last six years: 47 percent to the spinning sector and only 15 percent to the weaving sector. Neither sector is at full capacity. Very little of this investment has gone into the value added sectors, such as garments and home textiles. However the few, large firms which have invested in these products are highly automated, comply with international labor and environmental standards, and are very profitable. However, they are worried about competition from China following safeguards expiration. Moreover, Pakistan's Textile Ministry sources do not believe the sector will be able to sustain this level of investment because of rising interest rates.

¶9. (SBU) Pakistan has enjoyed a comparative advantage in textile categories, including bed linens, cotton fabrics, denim jeans, and knitted shirts; however, India is entering into these areas and is becoming more competitive. Textile Ministry officials told us that India provides Rs.350 billion (USD 7.2 billion) in subsidies to its textile sector and has identified it as a major employment generation sector. Compared to India, Pakistan's textile industry faces high utility prices, low labor productivity, and energy shortages, which make its products less competitive. GOP officials regularly acknowledge that Pakistan's overall textile industry also focuses more on low end products finished goods export market. The lack of brand ownership and export quality are impediments to moving up in value added chain. However, any move to the high end market will require new investment in high tech plants that comply with international environmental and labor standards, which is unlikely for the small family firms which still dominate Pakistan's textile sector.

Chinese textile safeguards help Pakistan
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¶10. (SBU) U.S and EU safeguard measures on Chinese textile and apparel exports have opened export opportunities for Pakistan in certain categories, including socks, ladies' outer garments, cotton trousers and cotton tee shirts. Pakistan, however, is not competitive in many of the 34 categories of the U.S.- China safeguard agreement. Pakistan has not imposed any safeguard measures on Chinese textile imports, nor is it contemplating any such measures. In fact, Pakistan and China signed an FTA in November

2006, which permits duty-free imports of most of Chinese textiles into Pakistan. Pakistan is importing raw cotton, filament yarn, woven fabrics, apparel and finding and trimmings., knitted fabrics and hosiery from China. China mostly imports raw cotton, cotton yarn, cotton thread and grey fabrics from Pakistan.

¶11. (SBU) According to Textile Ministry sources, some 30 of 525 spinning factories closed within the last fiscal year. Mostly unskilled labor lost jobs due to these closures. Belated GOP efforts to boost vocational training have not kept up with demand for skilled textile workers, and Pakistan continues to experience shortages of skilled workers and mid-level managers. The GOP recently increased the national minimum wage from 4000 ($65.57) per month to 4600 rupees ($75.40) per month.

¶12. Pakistan's labor legislation is generally consistent with the core ILO conventions, but enforcement is spotty, due to a lack of capacity. Better working conditions, pay, work schedules, maternity leave and other similar issues tend to be concentrated in the export sector. Very few plants, however, are unionized. The government is amending its labor laws and factories acts to bring textile exporters into compliance with ILO standards. However, labor laws do not apply in EPZs. The Labor Ministry is working on labor regulations for EPZs with the help of Asian Development Bank. Labor laws do apply in industrial parks.

Initiatives Undertaken to Increase Pakistan's Textile Competitiveness
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¶13. (SBU) The GOP and private sector have undertaken a number of initiatives to improve the industry's competitiveness. The State Bank of Pakistan is providing long-term financing for export-oriented projects at 7 and 6 percent, respectively, for 7-year and 3-year periods (well below current market interest rates of 12 to 13 percent). A research and development subsidy of 6 percent of the export value given two years back for ready-made garments and knitwear exports will continue this year. In addition, a research and development subsidy has also been provided to exports of dyed/printed fabrics and home textiles at 3 percent of export value, and to dyed/printed home textiles at 5 percent of export value. The purpose of these research and development subsidies is to improve quality and to increase market share. The GOP considers

that its R&D subsidies are WTO-consistent.

¶14. (SBU) The GOP is constructing textile/apparel industrial parks in Karachi, (completed by the end of this year), Lahore, and Faisalabad (both to be completed by the mid-2008). The GOP still has not established tax break and duty incentives. The Commerce Ministry has advised the GOP that such a package would violate WTO rules. These new parks will provide infrastructure and utilities. By contrast, Pakistan's EPZs offer infrastructure facilities along with the tax and duty concessions on exports. The GOP has also eliminated the sales tax on the import and local supply of raw materials utilized in the entire textile manufacturing process and the import duties on the raw materials, sub-components and components used in the manufacturing of textile machinery for the production of textile products. Custom duties, sales tax and other taxes on imported raw materials for the manufacture of textile products have been eliminated to avoid the need for duty drawback and refund claims under the revised and simplified Duty Drawback Scheme for all textile producers.

Pakistan a Textile Preference Program Beneficiary
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¶15. (SBU) Pakistan is a beneficiary of various textile preference programs. China provides Pakistan with duty free access for its textiles under their bilateral Free Trade Agreement, which came into force in July 2007. According to Pakistan's Textile Ministry, China

is mostly importing raw materials such as cotton yarn, grey fabrics and unprocessed fabrics from Pakistan, rather than the higher value finished items. Pakistan is importing raw cotton, filament yarn, woven fabrics, apparel and clothing accessories, knitted fabrics and hosiery from China.

¶16. (SBU) Most Pakistani textiles and apparel are beneficiaries of the EU's regular GSP program since January 2006. This program gives a 20 percent reduction in MFN duties for textiles. This program, however, does not compare favorably with the GSP-Plus concessions granted to other countries. (Comment: The EU's GSP Plus Program extends duty free treatment to textile products and also covers larger number of commodities compared to the EU's regular GSP program. End Comment.) GOP officials maintain that Bangladesh's and Sri Lanka's EU GSP-plus status gives their products a competitive advantage. The EU also imposed 13.1 percent anti-dumping duty on Pakistani bed linen, which was subsequently reduced to 5.8 percent after consultations. Pakistan has not taken this case to the WTO because consultations are on-going. The GOP is pessimistic that it will be able to remain competitive in U.S. and EU markets, where Pakistani textiles face 12-18 percent duties compared to tariff treatment under NAFTA, AGOA, and CAFTA beneficiaries receive. Pakistan also has a free trade agreement with Sri Lanka, but textiles are excluded. The South Asian Free Trade Agreement also extends duty free treatment to textiles but stringent non-tariff barriers effectively prohibit textile trade.

Private Sector View
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¶17. (SBU) All Pakistan Textile Mills Association (APTMA, which represents the producers of the yarn and fabrics) expressed its concern over last year's textile export performance. Textile exports fell short of the target by $600-700 million in FY06-07. They attributed the poor performance to rise in production costs, due to high cotton prices (70 percent of production costs) and expensive utilities (10 percent of production costs). Currently Pakistan consumes 16 million bales of cotton, but only produces 13 million bales (Pakistan imported high quality prima cotton from U.S. amounting to $117.8 million in 2006.), thus driving up the overall price for production. APTMA also attributed slow growth in the textile sector to India and Bangladesh's textile sector subsidies and the EU GSP-plus trade preferences for Bangladesh and Sri Lanka. In addition, interest rates have always been crucial for Pakistan's highly leveraged textile industry. Tightening monetary policy has made it more difficult for textile manufacturers to repay the loans

they took out in the era of cheaper money (When interest rates are low, Pakistani banks usually advance loans on floating interest rates.).

¶18. (SBU) The All Pakistan Readymade Garments Association sources said that the readymade garment sector had seen an increase in orders and enjoyed good growth prospects in the post-quota regime. However, they also expressed concern about inadequate infrastructure, high utility prices and bureaucratic problems such as procedural delays and red tape from Ministries of Finance, Commerce and Customs which prevent the sector from realizing its full potential. The Association especially appreciated the GOP Trade Policy initiative that provides for granting export processing zone status to those garment units that export 70 percent of their production.

Comment
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¶19. (SBU) With textiles comprising nearly two-thirds of Pakistan's export market, the GOP is right to be concerned about the performance of this sector. We were told in July that the part of the explanation for the drop in exports is the phase out of certain subsidies including duty and tax refund programs (which were being misused by small exporters) and their replacement with no duty/no drawback. However, the decreasing competitiveness of the sector,

sizeable subsidy programs in competitor countries, and greater EU trade preferences for key regional competitors are the primary causes for the drop in exports. We continue to be struck by the lack of planning and consideration for what could happen once the U.S. China safeguards expire. We are hopeful the passage of the Reconstruction Opportunity Zone (ROZ) legislation and possible establishment of textile plants in the ROZs will help increase exports. But the GOP and the textile sector need to focus on training, energy needs, infrastructure, and supply and competitiveness issues in order to maintain current market shares. End comment.